CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
RISK MANAGED ABSOLUTE RETURN STRATEGIES PROGRAM

April 21, 2008

This Policy is effective immediately upon adoption and supersedes all previous Risk Managed Absolute Return Strategies Program policies.

I. PURPOSE

The CalPERS Total Fund Statement of Investment Policy, adopted by the CalPERS Investment Committee ("Committee"), sets forth CalPERS' overarching investment purposes and objectives with respect to all its investment programs.

This document sets forth the investment policy ("Policy") for the Risk Managed Absolute Return Strategies Program ("Program", "RMARS"). The design of this Policy ensures that investors, managers, consultants, and other participants selected by the California Public Employees' Retirement System ("CalPERS") take prudent and careful action while managing the Program. Additionally, use of this Policy assures sufficient flexibility in managing investment risks and returns associated with this Program.

II. STRATEGIC OBJECTIVE

The Program's strategic objective is to broaden the opportunity set of CalPERS' investment portfolio by utilizing Absolute Return Funds to capitalize upon investment opportunities not available in traditional public markets investments.

The Program shall be managed to accomplish the following:

A. Enhance CalPERS' long-term total return, subject to the careful management of risk, consistent with an appropriate risk budget.

B. Hedge against long-term liabilities.

C. Provide diversification to CalPERS' overall investment program.

III. RESPONSIBILITIES

A. CalPERS' Investment Staff ("Staff") is responsible for the following:

1. All aspects of portfolio management, including monitoring, analyzing, and evaluating performance relative to the appropriate benchmark.

2. Evaluating and selecting Absolute Return Fund investment opportunities.

3. Reporting to the Committee no less than annually, and more often if needed, about the performance of the Program.

4. Monitoring the implementation of, and compliance with, the Policy. Staff shall report material violations of this Policy at the next Committee meeting, or sooner if deemed necessary. Staff will also report material concerns, problems or changes related to the Policy and Program to the Committee as appropriate. These reports shall include explanations of the violations or other matters and appropriate recommendations for corrective action.

5. Evaluating and selecting Absolute Return Fund Strategic Advisor(s) ("Strategic Advisor(s)"). The selection process shall use specific criteria with the objective of identifying and selecting Strategic Advisor(s) that have, but are not limited to, the following characteristics:

    a. Multiple senior personnel with significant amount of experience in the Absolute Return Fund industry.

    b. Breadth of expertise across many fund strategies.

    c. Robust quantitative disciplines for risk controls.

    d. Sound quantitative process for constructing a portfolio.

    e. Attractive fee arrangements.

    f. Desire to work with CalPERS in a labor intensive fashion.

    g. Commitment to providing CalPERS access to the most senior people within their organization.

    h. The ability to assist CalPERS to the extent necessary in securing scarce capacity and position level transparency from Absolute Return Funds.

6. Monitoring selected Investment Manager(s) to determine if the managers' actions and investment results are consistent with this Policy and other applicable CalPERS policies.

7. Overseeing the reconciliation of each investment by the Hedge Fund Administrator in accordance with Generally Accepted Accounting Principles on a monthly basis. The Hedge Fund Administrator shall provide an accounting ledger each month to Staff.

B. The General Pension Consultant ("Consultant") is responsible for:

Monitoring, evaluating, and reporting periodically to the Committee on the performance of the Program relative to the benchmark and policy.

C. Strategic Advisor(s)' responsibilities may include, but are not limited to, the following:

1. Assisting Staff in conducting the initial screening of potential Absolute Return Fund investments.

2. Assisting Staff in performing front and back office due diligence and evaluating the legal terms of prospective Absolute Return Fund investments.

3. Providing written opinions regarding Staff's recommendations to take significant actions such as allocating to or redeeming from an Absolute Return Fund.

4. Assisting staff in monitoring and evaluating the performance of the Program's investments relative to appropriate benchmarks and this Policy, in accordance with its agreement with CalPERS.

5. Providing advice and feedback on strategic initiatives and policies for the Program's future success.

D. The Investment Manager(s) is responsible for all aspects of portfolio management as set forth in the Investment Manager's agreement with CalPERS and shall fulfill the following duties:

1. Communicating with Staff as needed regarding investment strategy and investment results. The Investment Manager is expected to monitor, analyze, and evaluate performance relative to any agreed-upon benchmarks.

2. Cooperating with Staff and the Program's Hedge Fund Administrator, and Strategic Partner(s) requests for information.

3. Complying with CalPERS' reporting requirements, including but not limited to, accounting for fees and expenses.

IV. PERFORMANCE OBJECTIVE AND BENCHMARK

A. Performance Objective

Absolute Return Funds are highly specialized investments; therefore, CalPERS shall establish performance objectives for each Absolute Return Fund. These objectives shall be set at levels that are consistent with the strategy employed by each Absolute Return Fund's Investment Manager.

The Program shall pursue the following objectives:

1. Targeted Risk

The Program level risk target shall be no greater than one-half the five year annualized volatility of CalPERS' Internal Wilshire 2500 Equity Index Fund, and that the Program shall be managed so that in any one month the decline in net asset value shall not exceed 10%.

2. Targeted Return

On an annual basis and for purposes of performance appraisals, the return target shall be the return of the one-year U.S. Treasury Bill rate plus 5% over a full market cycle (three to five years).

3. Targeted Liquidity

The majority of Absolute Return Fund assets within the Program are expected to be subject to an initial lock-up of one year or less. In addition, the majority of Absolute Return Fund assets within the Program are expected to be subject to quarterly or more frequent liquidity after the expiration of any lock-up.

B. Benchmark

Due to the wide range of markets in which the Program's investments shall be made, appropriate benchmarks shall be established for each specific Absolute Return Fund. Each fund's benchmark shall reflect the investment opportunity set or risk profile of the specific fund. These benchmarks shall be established prior to investment and shall be documented with each Investment Manager.

V. INVESTMENT APPROACHES AND PARAMETERS

A. Approach

1. Absolute Return Funds shall complement the traditional active management vehicles in the Global Equity Markets and AIM Investment Programs. Absolute Return Fund investments may include exposure to leverage or short selling of securities or both. The allocation of assets for the Program shall come from the active or passive investments from the Global Equity Markets Program.

2. The Program shall invest in Absolute Return Funds to generate the attractive risk-to-reward characteristics provided by these specialized and unique investment strategies.

3. The Program shall invest in Absolute Return Funds through partnerships or other formation structures, e.g., limited liability companies (LLCs), where the Investment Manager has expertise in the specified mandates and in related areas material to the success of each investment strategy. The justifications for a limited partnership or similar structure such as an LLC include, but are not limited to, the following:

    a. Financial Firewall: The limited liability of a partnership or LLC arrangement is important since Absolute Return Funds sometimes use derivatives and leverage. CalPERS, as a limited partner or member, has the benefit of this limited liability.

    b. Access Unique Approaches with Limited Liquidity: The key to successful Absolute Return Fund investing is in selecting vehicles where the specialization of the investment is sufficiently unique that the partnership or LLC structure is justified in limiting asset growth in the strategy, ensuring a proper investment time horizon, and protecting CalPERS from the vagaries of other investors who may not be like-minded. The goal is to ensure that the approaches selected for recommendation do not mirror traditional active management. The fees and expenses of investing in Absolute Return Funds may be higher than traditional active management. CalPERS shall not fund Absolute Return Funds that simply invest in traditional active management approaches at higher fees.

c. Access Unique Talent: The specialized and focused nature of Absolute Return Funds often requires more specialized investment skills than those needed for traditional active management. Some of these investment professionals manage money only in the partnership format or LLC structure.

4. The negotiation of terms in Absolute Return Funds shall protect the interests of CalPERS, and shall address at a minimum the following issues:

   a. Alignment of Interests: Vehicle terms including fees shall be negotiated to align the Investment Manager's interest with CalPERS, acknowledging that market conditions may not permit "optimal" terms for each Absolute Return Fund. The fee structure, performance objective, restrictions on permitted investments, lock-up period, and other relevant terms shall seek to protect CalPERS in the event of adverse performance results, while ensuring that the limited liability status is maintained.

   b. Leverage: It is recognized that Absolute Return Funds may expose CalPERS' assets to leverage, meaning that a fund's financial exposures may exceed its invested capital. Therefore, Program investments should only be made in investment vehicles which provide limited liability and thereby protect the Program from losing more than its invested capital.

   c. Reporting Requirements: Each Investment Manager will be required to provide financial and investment reports which comply with geographically appropriate accounting standards (e.g., U.S. GAAP, International Financial Reporting Standards) and which provide Staff adequate information to properly assess and account for performance, fees, expenses, invested capital, and any other items affecting the investment. Monthly and quarterly investment updates are expected of each Investment Manager.

5. The Staff and consultant shall continually review the efficacy of absolute return-oriented investing. Staff shall present a formal review of the approach to the Committee on an annual basis.

B. Investment Selection

1. Absolute Return Funds may be selected if they enhance the

Program's ability to achieve its overall investment objective. Absolute Return Funds may include investments in domestic equity, international equity, fixed income, and other securities through approaches that may include, but are not limited to, the following *strategies* (as defined by the leading industry-recognized absolute return fund indices):

a. Directional Trading

b. Event Driven

c. Fund of Absolute Return Funds

d. Multi-Process

e. Security Selection

f. Specialist Credit

2. The following absolute return fund investment *styles* shall be considered for the Program that may include, but are not limited to, the following (as defined by the leading industry-recognized absolute return fund indices):

a. Commodity Trading Advisors

b. Convertible Arbitrage

c. Distressed Securities

d. Fixed Income Arbitrage

e. Long/Short Credit

f. Long/Short Equity

g. Market Neutral

h. Merger Arbitrage

i. Multiple Arbitrage

j. Statistical Arbitrage

3. Staff shall develop and maintain selection guidelines for prospective absolute return funds. To ensure conformity to the

Committee's risk and return expectations, these criteria shall be subject to review by:

a. Staff;

b. Strategic Advisor(s); and

c. The Consultant.

The selection guidelines may include, but are not limited to, the following:

d. Minimum requirements with respect to the following:

   (1) Investment Manager Investment Experience

   (2) Basic Investment Vehicle Terms

   (3) Investment Goals and Objectives

   (4) Degree of Leverage

e. Performance criteria

f. Due diligence process

g. Legal constraints or requirements

h. Reporting requirements

i. Quality control processes including, but not limited to, investment monitoring and risk control

j. Other relevant parameters that may apply

C. Investment Parameters

Investment Managers in Absolute Return Funds shall operate under a limited partnership agreement, or other similar legal structure, which includes specific, written investment guidelines. The guidelines shall outline the Investment Manager's investment philosophy and approaches, representative portfolio characteristics, permissible and restricted securities and procedures, and a performance objective commensurate with the investment risk to be incurred.

Implementation of this Program shall comply at all times with applicable

CalPERS investment policies.

D. Risk Parameters

Each Program investment shall have specified a set of risk parameters appropriate for that investment. Staff shall utilize the risk platform that has been internally developed to measure and monitor quantitatively the economic and investment risks associated with the Program, and shall further utilize the judgments and advice of the Strategic Advisor(s) and the Consultant to assess the qualitative risks inherent in managing the Program.

VI. CALCULATIONS AND COMPUTATIONS

Investors, managers, consultants, and other participants selected by CalPERS shall make all calculations and computations on a market value basis as recorded by CalPERS' Custodian and the Hedge Fund Administrator.

VII. GLOSSARY OF TERMS

Key words used in this policy are defined in CalPERS' Master Glossary of Terms.

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